UNIVERSITY OF ALASKA

(A Component Unit of the State of Alaska)

Financial Statements

June 30, 2004 and 2003

(With Independent Auditors' Report Thereon)

University of Alaska
(A Component Unit of the State of Alaska)
Financial Statements
June 30, 2004 and 2003

Table of Contents

Introduction

The following discussion and analysis provides an overview of the financial position and activities of the University of Alaska (university) for the years ended June 30, 2004 (fiscal year 2004) and June 30, 2003 (fiscal year 2003), with selected comparative information for the year ended June 30, 2002. This discussion has been prepared by management and should be read in conjunction with the financial statements including the notes thereto, which follow this section.

Using the Financial Statements

The university's financial report includes the basic financial statements of the university and the financial statements of the University of Alaska Foundation (foundation), a legally separate, non profit component unit. The three basic financial statements of the university are: the Statement of Net Assets, the Statement of Revenues, Expenses and Changes in Net Assets and the Statement of Cash Flows. These statements are prepared in accordance with generally accepted accounting principles and Governmental Accounting Standards Board (GASB) pronouncements. The university is presented as a business-type activity as prescribed by GASB Statement No. 35, *Basic Financial Statements - and Management's Discussion and Analysis – for Public Colleges and Universities*. The statement establishes standards for external financial reporting for public colleges and universities and classifies resources into three net asset categories – unrestricted, restricted, and invested in capital assets, net of related debt.

Commencing in fiscal year 2004, the University of Alaska Foundation is presented as a component unit of the university in accordance with GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*. The university's fiscal year 2003 financial statements have been restated to conform to the requirements of GASB Statement No. 39. The foundation's financial statements include the Statement of Financial Position and the Statement of Activities and these statements are presented as originally audited according to generally accepted accounting principles and Financial Accounting Standards Board (FASB) pronouncements.

The foundation was established to solicit donations and to hold and manage such assets for the exclusive benefit of the university. Resources managed by the foundation and distributions made to the university are governed by the foundation's Board of Trustees (operating independently and separately from the university's Board of Regents). The component unit status of the foundation indicates that significant resources are held by the foundation for the sole benefit of the university. However, the university is not accountable for, nor has ownership of, the foundation's resources.

Statement of Net Assets

The Statement of Net Assets presents the financial position of the university at the end of the fiscal year and includes all assets and liabilities of the university. The difference between total assets and total liabilities (net assets) is one indicator of the financial condition of the university, while the change in net assets is an indicator of whether the financial condition has improved or declined during the year. A summarized comparison of the university's assets, liabilities and net assets at June 30, 2004, 2003 and 2002 follows (in thousands):

	2004	2003	2002
Assets:			
Current assets	$ 109,721	$ 107,186	$ 89,340
Other assets	182,960	173,719	154,987
Capital assets, net of depreciation	760,757	703,855	651,268
Total assets	1,053,438	984,760	895,595
Liabilities:			
Current liabilities	69,631	74,547	62,551
Noncurrent liabilities	133,576	127,699	98,412
Total liabilities	203,207	202,246	160,963
Net assets			
Invested in capital assets, net of debt	648,016	602,274	564,771
Restricted – expendable	36,591	31,102	32,631
Restricted – nonexpendable	111,142	108,303	100,716
Unrestricted	54,482	40,835	36,514
Total net assets	$ 850,231	$ 782,514	$ 734,632

The financial position of the university improved during fiscal year 2004. This is primarily evidenced by the overall growth in net assets of $67.7 million, or 8.7 percent. Unrestricted net assets, a common indicator of financial strength or flexibility, increased 33.4 percent to $54.5 million at June 30, 2004. Other indicators of an improved financial position include an increase in working capital, reduced accounts receivable, and growth in endowment investments. Despite new general revenue bond issues of $21.0 million, reductions in accounts payable and consumption of advanced capital appropriations resulted in total liabilities increasing by only $1.0 million. Each of these changes is discussed in more detail in the sections that follow.

Working capital (current assets less current liabilities) over the past year increased from $32.6 million to $40.1 million. Working capital at year end represents 27 days of operating expenses, as compared to 23 days in 2003. The improvement can be attributed primarily to the increase in tuition revenue.

Net accounts receivable decreased 23 percent, from $74.9 million at June 30, 2003 to $58.0 million at June 30, 2004. The decrease is primarily due to capital project receivables decreasing by $10.6 million to $11.7 million at June 30, 2004. The other components of accounts receivable consist of those from operations, such as tuition and fees and sponsored programs (primarily research). Days of operating revenue in accounts receivable from operations decreased from 70 in 2003 to 56 in 2004. Management is continuing to work on improving the billing and collection process. See Note 4 of the financial statements for accounts receivable detail.

The decrease in accounts payable from $20.7 million at June 30, 2003 to $13.2 million at June 30, 2004 is a reflection of the decrease in capital construction activity in process at year end. At June 30, 2004, construction activity constituted about half, or $6.7 million, of the accounts payable balance and in the prior year it represented $10.4 million. The remaining accounts payable balance represents amounts due for recurring supplies and services for operations.

Capital appropriations advanced from the state prior to expenditure totaled $8.6 million at June 30, 2004, down from $14.7 million at June 30, 2003. This decrease was primarily due to the expenditure of $5.5 million for the Hutchison Career Center expansion and renovation, which was nearly complete at June 30, 2004. Further discussion of capital activity is in the *Capital and Debt Activities* section that follows.

Unrestricted net assets increased $13.6 million from June 30, 2003 to June 30, 2004. At year end, $37.9 million of the $54.5 million total is designated by the Board of Regents for specific purposes or otherwise limited by contractual agreements with external parties. See Note 2 of the financial statements for a detailed list of these designations.

Fiscal Year 2003 Comparisons (Statement of Net Assets)

For comparative purposes, significant comments about changes between 2002 and 2003 that were noted in fiscal year 2003 Management's Discussion and Analysis are summarized below:

Major changes from 2002 to 2003 on the Statement of Net Assets include those with accounts receivable, working capital and accounts payable. Net accounts receivable increased 19 percent, from $62.9 million at June 30, 2002, to $74.9 million at June 30, 2003. The growth was primarily due to the increase in receivables from cost reimbursable construction contracts, which grew from $8.9 million in 2002 to $22.3 million in 2003. Working capital (current assets less current liabilities) increased from $26.8 million at June 30, 2002 to $32.6 million at June 30, 2003. Working capital at June 30, 2003 represented 23 days of operating expenses, as compared to 20 days in 2002. The improvement could be attributed to a reduced level of spending in anticipation of increases in benefit rates for health care and anticipation of less growth in annual state appropriations in future years. The increase in accounts payable from $10.8 million at June 30, 2002 to $20.7 million and June 30, 2003 was a reflection of the significant capital construction activity in process at June 30, 2003. Accounts payable for construction activity constituted about half, or $10.4 million, of the accounts payable balance at June 30, 2003.

Statement of Revenues, Expenses and Changes in Net Assets

The Statement of Revenues, Expenses and Changes in Net Assets presents the results of operations for the university as a whole. Revenues, expenses and other changes in net assets are reported as either operating or nonoperating. Significant recurring sources of university revenue, such as state appropriations and investment earnings, are defined by GASB Statement No. 35 as nonoperating. A summarized comparison of the university's revenues, expenses and changes in net assets for the years ended June 30, 2004, 2003 and 2002 follows (in thousands):

	2004	2003	2002
Operating revenues	$ 299,677	$ 275,126	$ 244,303
Operating expenses	(549,236)	(528,148)	(497,054)
Operating loss	(249,559)	(253,022)	(252,751)
Net nonoperating revenues	230,706	221,264	195,723
Loss before other revenues, expenses, gains, or losses	(18,853)	(31,758)	(57,028)
Other revenues, expenses, gains or losses	86,570	79,640	44,556
Increase (decrease) in net assets	67,717	47,882	(12,472)
Net assets at beginning of year	782,514	734,632	747,104
Net assets at end of year	$ 850,231	$ 782,514	$ 734,632

The Statement of Revenues, Expenses and Changes in Net Assets reflects an overall increase in net assets of 8.7 percent, or $67.7 million. The primary factor for the increase in net assets is attributed to $86.6 million revenue recognized from capital funding sources, such as state capital appropriations. Revenue from capital sources is generally recognized as expenditures for capital projects occur. Fiscal year 2004 represents a year of significant capital construction activity as discussed further in the *Capital and Debt Activities* section which follows.

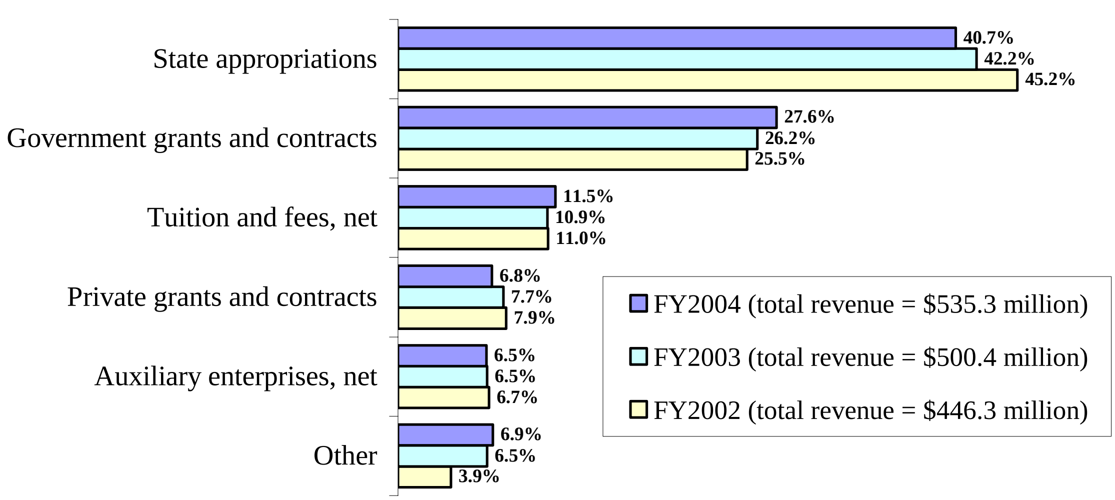
Student enrollment and tuition rate increases for the 2003-2004 academic year provided for gross student tuition and fee revenue of $67.8 million in fiscal year 2004 as compared to $59.8 million in fiscal year 2003. This was due in large part to a 10 percent increase in tuition rates for academic year 2003-2004. Student full-time equivalent enrollment for Fall 2003 was 17,319, a 4.2 percent increase from the prior Fall period.

Endowment proceeds and investment income contributed positively to the increase in net assets by providing $16.2 million in 2004 as compared to $11.8 million in 2003. A significant component of these amounts is investment income, generated from the endowment principal. Total return from the endowment was approximately 14 percent, or $10.6 million, in 2004 as compared to a 1 percent return, or $0.9 million, in the prior year. The other major component in this category is yield from, or sales of, trust land, timber and mineral interests, the net proceeds of which are required to be deposited to the land grant endowment trust fund. These sources generated revenue of $5.6 million in 2004 as compared to $10.9 million in 2003. The decrease was primarily due to poor market conditions for timber production leading to decreased timber sales.

State of Alaska general fund appropriations continue to be the single major source of revenue for the university, providing $217.7 million in 2004, as compared to $211.2 million in 2003. Historically, the Legislature has funded the university at an amount equal to or above the prior period's appropriation.

A comparison of operating and nonoperating revenues by source for fiscal year 2004, 2003 and 2002 follows:

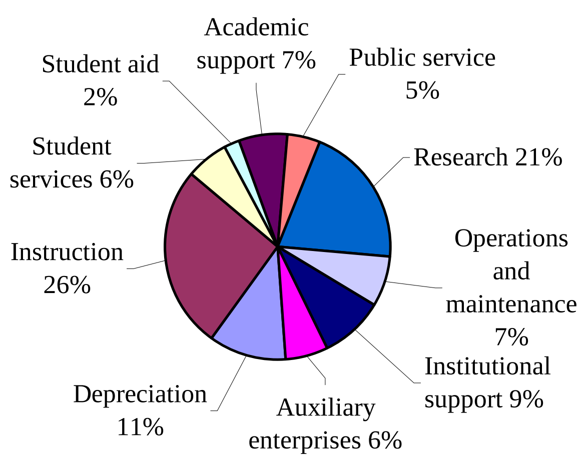
Operating and Nonoperating Revenues (excluding capital) by Year



Revenues from federal and other sources for sponsored research and education-related programs increased 9 percent, from $169.9 million in 2003 to $184.4 million in 2004. Facility and administrative cost recovery provided $29.7 million in 2004 as compared to $26.5 million in 2003. This increased funding enables the university to expand existing programs and start new programs, like those in fisheries, data analysis and basic research. In addition to supporting new programs, facility and administrative cost recovery reimburses the university for facilities and administrative costs necessary to operate and support sponsored programs, and provides cash flow to service debt on, and renew, research facilities.

A comparison of operating expenses by functional and natural classification for selected fiscal years follows (see Note 16 of the financial statements for more information):

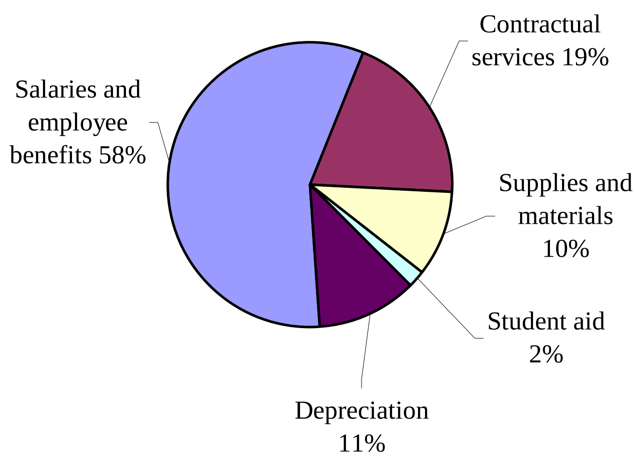
Fiscal Year 2004
Functional Classification



Operating Expenses
Functional Classification (in millions)

	FY2004		FY2003		FY2002	
Instruction	$144.1	26.2%	$134.2	25.4%	$124.0	24.9%
Student Services	33.0	6.0%	31.3	5.9%	28.7	5.8%
Student Aid	13.0	2.4%	10.4	2.0%	9.4	1.9%
Academic Support	37.1	6.8%	34.3	6.5%	30.4	6.1%
Public Service	26.2	4.8%	25.0	4.7%	22.3	4.5%
Research	112.0	20.4%	107.6	20.4%	97.2	19.6%
Operations and Maintenance	39.2	7.0%	40.3	7.7%	42.2	8.5%
Institutional Support	50.3	9.2%	53.5	10.1%	56.1	11.3%
Auxiliary Enterprises	33.8	6.2%	31.8	6.0%	28.9	5.8%
Depreciation	60.5	11.0%	59.7	11.3%	57.8	11.6%
	$549.2	100.0%	$528.1	100.0%	$497.0	100.0%

Fiscal Year 2004
Natural Classification



Operating Expenses
Natural Classification (in millions)

	FY2004		FY2003		FY2002	
Salaries and Employee Benefits	$319.2	58.1%	$300.9	57.0%	$275.4	55.4%
Contractual Services	102.1	18.6%	105.3	19.9%	100.8	20.3%
Supplies and Materials	54.4	9.9%	51.8	9.8%	53.6	10.8%
Student Aid	13.0	2.4%	10.4	2.0%	9.4	1.9%
Depreciation	60.5	11.0%	59.7	11.3%	57.8	11.6%
	$549.2	100.0%	$528.1	100.0%	$497.0	100.0%

Fiscal Year 2003 Comparisons (Statement of Revenues, Expenses and Changes in Net Assets)

For comparative purposes, significant comments about changes between 2002 and 2003 that were noted in fiscal year 2003 Management's Discussion and Analysis are summarized below:

The Statement of Revenues, Expenses and Changes in Net Assets reflected an overall increase in net assets of 6.5 percent, or $47.9 million, from 2002 to 2003. The significant factors affecting the fiscal year 2003 increase in net assets included $79.6 million revenue recognized from capital funding sources, such as state capital appropriations and bond proceeds, which exceeded depreciation expense of $59.7 million. Endowment proceeds and investment income also contributed positively to the increase in net assets by providing $11.8 million in 2003 as compared to a loss of $1.8 million in 2002. Total return from the consolidated fund was approximately 1 percent in 2003 as compared to a loss of 7 percent in 2002.

Other major revenue sources include state general fund appropriations, sponsored programs and tuition revenue. State general fund appropriations increased to $211.2 million in 2003, as compared to $201.6 million in 2002. Sponsored program revenue, primarily from research and education related programs, increased 14 percent, from $148.8 million in 2002 to $169.9 million in 2003. Facility and administrative cost recovery provided $26.5 million in 2003 as compared to $22.7 million in 2002. Student enrollment and tuition rate increases for the 2002-2003 academic year provided for gross student tuition and fee revenue of $59.8 million in fiscal year 2003 as compared to $54.2 million in fiscal year 2002. Student full-time equivalent enrollment for Fall 2002 was 16,624, an 8.1 percent increase from the prior Fall period. Tuition rates increased 3.2 percent for academic year 2002-2003, roughly equal to the estimated inflationary impact on the costs of providing higher education.

Capital and Debt Activities

The University of Alaska has continued to modernize various facilities and to build new facilities to address emerging state needs. Net capital additions totaled $110.8 million in 2004, as compared with $104.2 million in 2003 and $50.1 million in 2002. These capital additions primarily comprise replacement, renovation and new construction of academic and research facilities, as well as investments in equipment and information technology. At June 30, 2004, $57.7 million remains unexpended from current and prior year capital appropriations and general revenue bond proceeds, of which $20.8 million is committed to existing construction contracts. The balance is for projects still in design or preconstruction, or is held for contingencies for work in progress. At June 30, 2004, $9.6 million in private gifts and grants for construction of the University of Alaska Museum addition and renovation remain unexpended. Such gifts, held by the University of Alaska Foundation, will be received by the university on a reimbursement basis during the museum construction.

Construction in progress at June 30, 2004 totaled $72.1 million. Major new facility construction in progress at year end includes the University of Alaska Museum addition and renovation in Fairbanks, the Hutchison Career Center renovation and expansion in Fairbanks, and the University of Alaska Southeast Joint Readiness Center in Juneau.

At June 30, 2004, total debt outstanding was $113.1 million, comprised of $84.4 million in general revenue bonds, $27.8 million in notes payable, and $0.9 million in lease finance contracts. In December 2003, Moody's Investors Service affirmed its previous university credit rating of A1 with stable outlook. In December 2003, Standard & Poor's affirmed its rating of AA- for bonds backed by its broad general revenue pledge. The University has maintained these ratings since its general revenue issues were first rated in 1992.

The university had two general revenue bond issues in 2004 totaling $21,040,000. The Series L bond issue totaled $9,970,000 and matures on October 1, 2030, bearing interest at rates ranging from 3 percent to 4.7 percent. Series L bond proceeds totaling $7,780,000 are being used for capital improvement projects, while the remaining $2,190,000 was used to redeem all of 1993 Series F general revenue bonds. The Series M bond issue totaled $11,070,000. The bonds mature on October 1, 2028 and bear interest at rates ranging from 3.25 percent to 4.75 percent. Series M bond proceeds totaling $8,680,000 are being used for capital improvement projects and acquisition of real estate, and the remaining $2,390,000 was used to refinance a deed of trust note originally issued for the purchase of two buildings located in Anchorage.

Bonds were issued in prior years to finance construction of student residences at three campuses, the West Ridge Research Building, a student recreation center, a research facility to house the International Arctic Research Center, the acquisition and renovation of several properties adjacent to the university's campuses, additions to the university's self-operated power, heat, water and telephone utility systems in Fairbanks, and to refund previously issued general revenue bonds and other contractual obligations in order to realize debt service savings.

The university has traditionally utilized both tax exempt and non-tax exempt equipment lease financings to provide for its capital needs or to facilitate systematic renewals. Short-term lines of credit are available to provide interim cash flow financing for facilities intended to be funded with general revenue bond proceeds.

Other Economic and Financial Conditions

The following is a description of currently known facts, decisions, or conditions that are expected to have a significant effect on the financial position (net assets) or results of operations (revenues, expenses, and other changes in net assets) of the university.

At their September 2003 meeting, the Board of Regents approved a 10 percent increase in tuition for resident students (20 percent for non-residents) for the 2004 - 2005 academic year. During Spring semester 2005, the administration will institute a network charge equal to 2 percent of tuition that will be used to fund information technology network access and maintenance. At their September 2004 meeting, the Board of Regents approved a 10 percent increase in tuition for the 2005 – 2006 academic year.

Substantially all regular university employees participate in either the State of Alaska Public Employees' Retirement System (PERS), the State of Alaska Teachers' Retirement System (TRS), or the University of Alaska Optional Retirement Plan (ORP). Based on actuarial studies completed as of June 30, 2003, the university's funded ratio (actuarial value of plan assets to actuarial accrued liability) for PERS was 75 percent. Unlike PERS, TRS does not maintain individual employer funded ratios, however, the overall TRS funded ratio as actuarially determined at June 30, 2003 was 64 percent. The low funded ratios can be attributed primarily to rising health care costs for plan participants and declines in investment returns in prior years. In April 2004, the PERS and TRS boards set the university's contribution rates for fiscal year 2006 at 15.58 percent and 21.0 percent of applicable gross pay for PERS and TRS, respectively. This is an increase from fiscal year 2005 rates of 10.58 percent and 16.0 percent. See Note 12 of the financial statements for more information regarding pension plans.

For fiscal year 2005, state appropriations for operations and debt service reimbursement total $232.6 million, and include an $11.7 million incremental increase from the prior year to meet the rising cost of the PERS and TRS employer contributions and other salary increases. Ongoing state budget requests include funding for the fiscal year 2006 rise in the retirement plans' employer contribution rates in addition to a 5 percent increase from base state funding. The level of annual state appropriation funding is conditional upon the legislative process, which is directly influenced by current economic conditions and other factors. The university continues to seek additional revenues from sources other than state appropriations, to decrease its reliance on state appropriations as a percent of total revenue.

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Independent Auditors' Report

The Board of Regents
University of Alaska:

We have audited the accompanying basic financial statements of the University of Alaska (University), a component unit of the State of Alaska, as of and for the years ended June 30, 2004 and 2003 as listed in the table of contents. These financial statements are the responsibility of the university's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Alaska at June 30, 2004 and 2003, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 1 to the financial statements effective July 1, 2002, the University of Alaska adopted Governmental Accounting Standards Board (GASB) Statement No. 39, *Determining Whether Certain Organizations Are Component Units.*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 30, 2004 on our consideration of the University of Alaska's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis, on pages 1 through 8 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

September 30, 2004

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UNIVERSITY OF ALASKA
(A Component Unit of the State of Alaska)
Statements of Net Assets
June 30, 2004 and 2003
(in thousands)

Assets	2004	2003
Currents assets:		
Cash and cash equivalents	$ 41,815	$ 22,147
Short-term investments	1,231	1,215
Accounts receivable, less allowance of $3,990 in 2004 and $4,118 in 2003	57,974	74,926
Other assets	640	1,254
Inventories	8,061	7,644
Total current assets	109,721	107,186
Noncurrent assets:		
Restricted cash and cash equivalents	19,164	21,577
Notes receivable	5,212	5,802
Endowment investments	93,834	81,579
Endowed land and other assets	38,358	38,953
Long-term investments	20,694	20,350
Assets held in trust	5,698	5,458
Capital assets, net of accumulated depreciation of $493,386 in 2004 and $439,489 in 2003	760,757	703,855
Total noncurrent assets	943,717	877,574
Total assets	1,053,438	984,760
Liabilities		
Current liabilities:		
Accounts payable	13,246	20,677
Accrued expenses	4,156	3,576
Accrued payroll	13,563	11,486
Deferred revenue	3,553	3,331
Accrued annual leave	8,152	7,968
Deferred lease revenue - current portion	1,281	1,281
Long-term debt - current portion	4,855	4,354
Insurance and risk management	18,591	19,421
Deposits from students and others	2,234	2,453
Total current liabilities	69,631	74,547
Noncurrent liabilities:		
Capital appropriation advances	8,633	14,684
Deferred lease revenue	11,209	12,490
Long-term debt	108,239	95,961
Security deposits and other liabilities	5,495	4,564
Total noncurrent liabilities	133,576	127,699
Total liabilities	203,207	202,246
Net Assets		
Invested in capital assets, net of related debt	648,016	602,274
Restricted:		
Expendable:		
Restricted funds	1,512	1,551
Student loan funds	259	716
Education Trust of Alaska	4,843	5,463
Capital projects	2,925	3,584
Debt service	3,092	3,283
Endowment	23,960	16,505
Nonexpendable	111,142	108,303
Unrestricted (see Note 2)	54,482	40,835
Total net assets	$ 850,231	$ 782,514

The accompanying notes are an integral part of the financial statements.

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UNIVERSITY OF ALASKA FOUNDATION
(A Component Unit of the University of Alaska)
Statements of Financial Position
June 30, 2004 and 2003
(in thousands)

Assets	2004	2003
Cash and cash equivalents	$ 3,662	$ 2,802
Interest receivable	281	270
Short term investments	48	-
Contributions receivable	7,621	8,499
Escrows receivable	621	692
Inventory	74	78
Other assets	410	434
Remainder trust receivable	391	407
Pooled endowment funds	69,246	55,386
Other long term investments	46,658	47,362
Total assets	$ 129,012	$ 115,930
Liabilities		
Due to the University of Alaska	$ 3,631	$ 1,617
Other liabilities	36	5
Remainder trust obligations	158	172
Term endowment liability	1,000	1,000
Total liabilities	4,825	2,794
Net Assets		
Unrestricted	29,439	25,943
Temporarily restricted	50,962	47,579
Permanently restricted	43,786	39,614
Total net assets	124,187	113,136
Total liabilities and net assets	$ 129,012	$ 115,930

The accompanying notes are an integral part of the financial statements.

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UNIVERSITY OF ALASKA
(A Component Unit of the State of Alaska)
Statements of Revenues, Expenses and Changes in Net Assets
For the Years Ended June 30, 2004 and 2003
(in thousands)

	2004	2003
Operating revenues		
Student tuition and fees	$ 67,756	$ 59,825
less tuition allowances	(6,260)	(5,256)
	61,496	54,569
Federal grants and contracts	133,897	115,996
State grants and contracts	10,520	11,775
Local grants and contracts	3,313	3,547
Private grants and contracts	36,641	38,617
Federal appropriations	2,758	2,214
Local appropriations	705	705
Sales and services, educational departments	3,415	3,681
Sales and services, auxiliary enterprises, net of tuition allowances of $1,298 in 2004 and $1,151 in 2003	34,605	32,283
Other	12,327	11,739
Total operating revenues	299,677	275,126
Operating expenses		
Instruction	144,115	134,192
Academic support	37,095	34,279
Research	112,013	107,615
Public service	26,216	24,967
Student services	33,002	31,323
Operations and maintenance	39,184	40,291
Institutional support	50,290	53,529
Student aid	13,052	10,441
Auxiliary enterprises	33,786	31,827
Depreciation	60,483	59,684
Total operating expenses	549,236	528,148
Operating loss	(249,559)	(253,022)
Nonoperating revenues (expenses)		
State appropriations	217,745	211,152
Investment earnings	1,674	2,411
Endowment proceeds and investment income	16,187	11,745
Interest on debt	(3,394)	(2,936)
Other nonoperating expenses	(1,506)	(1,108)
Net nonoperating revenues	230,706	221,264
Loss before other revenues, expenses, gains or losses	(18,853)	(31,758)
Capital appropriations, grants and contracts	86,570	79,640
Net increase in net assets	67,717	47,882
Net assets		
Net assets - beginning of year	782,514	734,632
Net assets - end of year	$ 850,231	$ 782,514

The accompanying notes are an integral part of the financial statements.

UNIVERSITY OF ALASKA FOUNDATION
(A Component Unit of the University of Alaska)
Statements of Activities
For the Years Ended June 30, 2004 and 2003
(in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	2004
Revenues, gains and other support				
Contributions	$ 1,317	$ 8,833	$ 4,016	$ 14,166
Investment income	1,401	1,514	-	2,915
Net realized and unrealized investment gains (losses)	1,752	4,216	-	5,968
Other revenues	5	124	-	129
Actuarial adjustment of remainder trust obligations	-	-	(25)	(25)
Gains (losses) on disposition of other assets	-	96	(1)	95
Transfers from the University of Alaska	-	1	142	143
Net assets released from restriction	11,360	(11,360)	-	-
Total revenues, gains and other support	15,835	3,424	4,132	23,391
Expenses and distributions				
Operating expenses	282	-	-	282
Distributions for the benefit of the University of Alaska	12,058	-	-	12,058
Total expenses and distributions	12,340	-	-	12,340
Excess of revenues over expenses	3,495	3,424	4,132	11,051
Transfers between net asset classes	-	(41)	41	-
Total transfers	-	(41)	41	-
Increase (decrease) in net assets	3,495	3,383	4,173	11,051
Net assets, beginning of year	25,944	47,578	39,614	113,136
Net assets, end of year	$ 29,439	$ 50,961	$ 43,787	$ 124,187

The accompanying notes are an integral part of the financial statements.

Unrestricted	Temporarily Restricted	Permanently Restricted	2003
$ 1,200	$ 10,183	$ 1,983	$ 13,366
1,485	993	-	2,478
(144)	719	-	575
-	90	4	94
-	(1)	(17)	(18)
9	-	-	9
92	24	-	116
9,553	(9,553)	-	-
12,195	2,455	1,970	16,620
230	-	-	230
8,687	-	-	8,687
8,917	-	-	8,917
3,278	2,455	1,970	7,703
-	4,010	(4,010)	-
-	4,010	(4,010)	-
3,278	6,465	(2,040)	7,703
22,666	41,113	41,654	105,433
$ 25,944	$ 47,578	$ 39,614	$ 113,136

UNIVERSITY OF ALASKA
(A Component Unit of the State of Alaska)
Statements of Cash Flows
For the Years Ended June 30, 2004 and 2003
(in thousands)

	2004	2003
Cash flows from operating activities		
Student tuition and fees, net	$ 61,900	$ 53,911
Grants and contracts	190,920	171,403
Sales and services, educational departments	3,415	3,680
Sales and services, auxiliary enterprises	34,554	32,666
Federal appropriations	2,758	2,214
Local appropriations	705	705
Other operating receipts	11,046	10,418
Payments to employees for salaries and benefits	(316,830)	(299,886)
Payments to suppliers	(158,595)	(154,653)
Payments to students for financial aid	(12,655)	(10,381)
Net cash used by operating activities	(182,782)	(189,923)
Cash flows from noncapital financing activities		
State appropriations	217,050	211,401
Other revenue, net	45	170
Direct lending receipts	51,397	45,418
Direct lending payments	(51,815)	(45,920)
Net cash provided by noncapital financing activities	216,677	211,069
Cash flows from capital and related financing activities		
Capital appropriations, grants and contracts	90,875	69,335
Proceeds from issuance of capital debt	21,134	33,515
Redemption of general revenue bonds	(4,392)	(3,885)
Purchases of capital assets	(122,016)	(102,479)
Principal paid on capital debt and leases	(4,486)	(3,650)
Interest paid on capital debt and leases	(4,002)	(3,302)
Net cash used by capital and related financing activities	(22,887)	(10,466)
Cash flows from investing activities		
Proceeds from sales and maturities of investments	9,340	3,776
Purchase of investments	(10,466)	(9,137)
Interest received on investments	608	709
Interest and other sales receipts from endowment assets	6,765	10,763
Net cash provided by investing activities	6,247	6,111
Net increase in cash and cash equivalents	17,255	16,791
Cash and cash equivalents, beginning of the year	43,724	26,933
Cash and cash equivalents, end of the year	$ 60,979	$ 43,724
Cash and cash equivalents (current)	$ 41,815	$ 22,147
Restricted cash and cash equivalents (noncurrent)	19,164	21,577
Total cash and cash equivalents	$ 60,979	$ 43,724

The accompanying notes are an integral part of the financial statements.

UNIVERSITY OF ALASKA
(A Component Unit of the State of Alaska)
Statements of Cash Flows
For the Years Ended June 30, 2004 and 2003
(in thousands)

Reconciliation of operating loss to net cash used by operating activities:	2004	2003
Operating loss	$ (249,559)	$ (253,022)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense	60,483	59,684
Changes in assets and liabilities:		
Accounts receivable, net	7,038	1,048
Other assets	713	(40)
Inventories	(417)	(738)
Accounts payable	(2,401)	3,472
Accrued expenses	951	(236)
Accrued payroll	2,077	1,011
Deferred revenue	222	(148)
Accrued annual leave	183	405
Deferred lease revenue - current portion	(1,281)	(1,281)
Insurance and risk management	(830)	(157)
Deposits from students and others	39	79
Net cash used by operating activities	$ (182,782)	$ (189,923)

Noncash Investing, Capital and Financing Activities:

For the Year Ended June 30, 2004

Additions to capital assets include $5.5 million expended and capitalized but not paid for at year end.

The university purchased equipment through a lease purchase contract totaling $0.6 million.

Losses on equipment disposals totaled $0.5 million.

Interest expense on general revenue bond financed projects totaling $0.6 million was capitalized during the year.

For the Year Ended June 30, 2003

Additions to capital assets include $7.7 million expended and capitalized but not paid for at year end.

The university purchased equipment through a lease purchase contract totaling $0.4 million.

Losses on equipment disposals totaled $0.8 million.

The State of Alaska transferred the Tanana Valley Campus Barnette Street facility to the university with a fair market value of $2.7 million.

NOTES TO FINANCIAL STATEMENTS

June 30, 2004 and 2003

1. Organization and Summary of Significant Accounting Policies:

Organization and Basis of Presentation:

The University of Alaska (university) is a constitutionally created corporation of the State of Alaska which is authorized to hold title to real and personal property and to issue debt in its own name. The university is a component unit of the State of Alaska for purposes of financial reporting. As an instrumentality of the State of Alaska, the university is exempt from federal income tax under Internal Revenue Code Section 115, except for unrelated business activities as covered under Internal Revenue Code Sections 511 to 514.

The University of Alaska Foundation (foundation) is a legally separate, non profit component unit of the university. The foundation was established to solicit donations and to hold and manage such assets for the exclusive benefit of the university. Resources managed by the foundation and distributions made to the university are governed by the foundation's Board of Trustees. Commencing in fiscal year 2004, Governmental Accounting Standards Board (GASB) Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, requires the university to include the foundation as part of its financial statements to better report resources benefiting the university. The university's fiscal year 2003 financial statements have been restated to conform to the requirements of GASB Statement No. 39. The university is not accountable for, nor has ownership of, the foundation's resources. The foundation's financial statements include the Statement of Financial Position and the Statement of Activities and these statements are presented in their original audited format according to Financial Accounting Standards Board (FASB) pronouncements.

In preparing the financial statements, management is required to make estimates that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the statement of net assets. Actual results could differ from those estimates. The more significant accounting and reporting policies and estimates applied in the preparation of the accompanying financial statements are discussed below.

GASB Statement No. 35 establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and reporting purposes into the following net asset categories:

- **Unrestricted Net Assets:** Assets, net of related liabilities, which are not subject to externally-imposed restrictions. Unrestricted net assets may be designated for specific purposes by the Board of Regents or may otherwise be limited by contractual agreements with outside parties.

- **Restricted Net Assets:**

  Expendable – Assets, net of related liabilities, which are subject to externally-imposed restrictions that may or will be met by actions of the university and/or that expire with the passage of time.

  Non-expendable – Assets, net of related liabilities, which are subject to externally-imposed restrictions requiring that they be maintained permanently by the university.

- **Invested in capital assets, net of related debt** – Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

Summary of Significant Accounting Policies:

The accompanying financial statements have been prepared on the economic resources measurement focus and the accrual basis of accounting. All significant intra-university transactions have been eliminated. The university reports as a business type activity, as defined by GASB Statement No. 35. Business type activities are those that are financed in whole or in part by fees charged to external parties for goods or services.

The university has the option to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB conflicts with GASB. The university has elected not to apply FASB pronouncements issued after the applicable date.

Cash and Cash Equivalents

All highly liquid investments, not held for long-term investment, with original maturities of three months or less are reported as cash and cash equivalents.

Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market.

Investments

Investments are stated at fair value. Investment securities are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statement of net assets. Long-term investments include those restricted by outside parties as to withdrawal or use for other than current operations, or are designated for expenditure in the acquisition or construction of noncurrent assets or held with an intent not to be used for operations.

Capital Assets

Capital assets are stated at cost when purchased and at fair value when donated. Equipment with a unit value of less than $2,500 is not capitalized. Certain land and other resources acquired through land grants and donated museum collections for which fair value at date of acquisition was not determinable are reported at zero basis in the financial statements.

Depreciation is computed on a straight-line basis with useful lives of building and building components ranging from 12 to 50 years, 10 to 35 years for infrastructure and other improvements, and 5 to 11 years for equipment. Library and museum collections are not depreciated because they are preserved and cared for and have an extraordinarily long useful life.

Endowments

Endowments consist primarily of the land grant endowment trust fund established pursuant to the 1929 federal land grant legislation and its related inflation proofing funds. AS 14.40.400 provides that the net income from the sale or use of grant lands must be held in trust in perpetuity. At June 30, 2004 and 2003 the accumulated net earnings and appreciation on investments is $24.0 million and $16.5 million, respectively. These amounts, which are recorded in the restricted expendable net asset category, are available for expenditure in accordance with spending policies established by the Board of Regents in its capacity as trustee. Alaska Statute 14.40.400 provides the Board of Regents with authority to manage the endowments under the total return principles which are intended to preserve and maintain the purchasing power of the endowment principal. The investable resources of the fund are invested in the consolidated fund, a unitized investment fund. The annual spending allowance is currently based on five percent of a five-year moving average of the invested balance. Withdrawals of net earnings appreciation to meet the spending allowance are limited to the unexpended accumulated net earnings of the endowments.

Operating Activities

The university's policy for defining operating activities as reported on the statement of revenues, expenses and changes in net assets are those that generally result from exchange transactions such as payments received for providing services and payments made for services or goods received. Certain significant revenue streams relied upon for operations are recorded as non-operating revenues, as defined by GASB Statement No. 35, including state appropriations and investment earnings.

Tuition Allowances

Student tuition and fee revenues and certain other revenues from students are reported net of tuition allowances in the statement of revenues, expenses and changes in net assets. Tuition allowances are the difference between the stated charge for tuition and room and board provided by the university and the amount paid by the student and/or third parties making payments on the students' behalf.

Lapse of State Appropriations

Alaska Statutes provide that unexpended balances of one-year appropriations will lapse on June 30 of the fiscal year of the appropriation; however, university receipts in excess of expenditures may be expended by the university in the next fiscal year. University receipts include student fees, donations, sales, rentals, facilities and administrative cost recovery, auxiliary and restricted revenues. The unexpended balances of capital appropriations lapse upon completion of the project or upon determination that the funds are no longer necessary for the project.

2. Unrestricted Net Assets:

At June 30, unrestricted net assets included the following (in thousands):

	2004	2003
Designated:		
Auxiliaries	$ 9,431	$ 9,529
Working capital fund	4,715	4,715
Service centers	6,227	4,473
Renewal and replacement funds	3,066	2,578
Quasi-endowment funds	79	79
Employee benefit funds	(1,065)	(7,389)
Endowment earnings	8,717	7,108
Encumbrances	6,697	7,159
Total designated	37,867	28,252
Undesignated	16,615	12,583
Total unrestricted net assets	$ 54,482	$ 40,835

Unrestricted net assets include non-lapsing university receipts of $29.5 million at June 30, 2004. Non-lapsing university receipts of $24.2 million from 2003 were fully expended in 2004.

At June 30, 2004 and 2003, $38.9 million and $33.7 million, respectively, of auxiliary funds, encumbrances and other unrestricted net assets were pledged as collateral for the university's general revenue bonds, as calculated under the terms of the 1992 General Revenue Bonds Trust Indenture.

3. Cash and Investments:

Alaska Statutes and Board of Regents' policy provide the university with broad authority to invest funds. GASB requires that bank balances and investment securities be disclosed or classified by category of credit risk as follows:

Deposits: Insured or collateralized with securities held by the university or its agent in the name of the university (category 1); collateralized with securities held by the pledging financial institution's trust department or agent in the name of the university (category 2); uncollateralized including collateralized balances for which securities are held by the pledging financial institution or by its trust department or agent but not in the name of the university (category 3).

Investment Securities: Insured or registered, with securities held by the university or its agent in the name of the university (category 1); Uninsured and unregistered, with securities held by the counterparty's (another party to the transaction, i.e. seller or dealer) trust department or agent in the name of the university (category 2); Uninsured and unregistered, with securities held by the counterparty's trust department or agent but not in the name of the university (category 3).

	2004		2003	
	Book	Bank	Book	Bank
Deposits (in thousands):				
Insured or collateralized (Category 1):				
Demand deposits	$ 329	$ 319	$ 304	$ 302
Time deposits	100	100	100	100
Uncollateralized (Category 3):				
Demand deposits	1,636	11,683	(16,721)	736
Time deposits	4,100	4,100	4,100	4,100
Total deposits	$ 6,165	$ 16,202	$ (12,217)	$ 5,238
Investment securities:				
Insured and registered (Category 1)				
Common stock		$ 2		$ 2
Uninsured and unregistered (Category 3)				
Repurchase agreements		7,268		16,399
Total investment securities		$ 7,270		$ 16,401
Other deposits and investments:				
Money market funds		$ 62		$ 120
Commonfund, short and intermediate term funds		41,729		35,227
Commonfund, absolute return fund		13,400		12,816
Funds held by others:				
Endowment funds		91,822		79,555
Bond proceeds and redemption funds		16,290		14,966
Total other deposits and investments		$ 163,303		$ 142,684

Deposits reported in Category 1 by the university were insured by federal depository insurance. Deposits and investments reported in Category 3 were secured under a tri-party agreement with Bank of New York to hold the collateral for the benefit of the university; however, the securities are not held in the name of the university. At June 30, 2004 and 2003, securities with an estimated fair value of $24.0 million and $26.4 million were held as collateral under the tri-party agreement. Time deposits consist of a non-interest bearing deposit in the amount of $4.2 million maintained as a compensating balance in exchange for banking services.

Repurchase agreements represent overnight investments secured under tri-party agreements with various bank trust departments to hold the collateral for the benefit of the university; however, the securities are not held in the name of the university. The Commonfund is a not-for-profit provider of pooled multi-manager investment vehicles for colleges and universities. Endowment funds are managed by the University of Alaska Foundation under a consolidated fund agreement. Bond proceeds and related redemption funds are held by bank trustees in accordance with debt covenants.

Certain funds held in trust for the benefit of the university are not included in the financial statements as the university has only limited control over their administration. These funds are in the custody of independent fiduciaries and at June 30, 2004 and 2003, had an estimated fair value of approximately $6.9 million and $6.5 million, respectively.

4. Accounts Receivable:

Accounts receivable consisted of the following at June 30, 2004 and 2003 (in thousands):

June 30, 2004	Gross	Allowance	Net
Student tuition and fees	$ 6,911	$ (1,669)	$ 5,242
Sponsored programs	42,032	(2,168)	39,864
Auxiliary services and other operating activities	632	(153)	479
Capital appropriations, grants and contracts	11,693	-	11,693
State operating appropriation	696	-	696
	$ 61,964	$ (3,990)	$ 57,974
June 30, 2003			
Student tuition and fees	$ 6,718	$ (1,368)	$ 5,350
Sponsored programs	49,014	(2,600)	46,414
Auxiliary services and other operating activities	1,009	(150)	859
Capital appropriations, grants and contracts	22,302	-	22,302
State operating appropriation	1	-	1
	$ 79,044	$ (4,118)	$ 74,926

5. Assets Held in Trust:

Assets held in trust include operating funds of the Education Trust of Alaska (Trust). The Trust was established pursuant to state statute on April 20, 2001 by the Board of Regents to facilitate administration of the state's Internal Revenue Code (IRC) Section 529 College Savings Program. The program is a nationally marketed college savings program developed in accordance with IRC Section 529 and includes the resources of the university's former Advance College Tuition (ACT) Program. Participant account balances of approximately $1,217 million and $714 million at June 30, 2004 and 2003, respectively, are not included in the financial statements.

Assets of the Trust are invested in various mutual funds at the direction of T. Rowe Price Associates, Inc., the program manager. The net assets of the Trust, which include a reserve for University of Alaska (UA) Tuition Value Guarantees, are available for payment of program administrative costs, benefits and other purposes of the Trust. Based on actuarial studies, management estimates reserve requirements for the UA Tuition Value Guarantees to be approximately $860,000 and $950,000 at June 30, 2004 and 2003, respectively.

6. Endowed Land and Other Assets:

Endowed land and other assets consist of real property and timber and other rights. By Acts of Congress in 1915 and 1929, approximately 110,000 acres of land was granted to the territory of Alaska to be held in trust for the benefit of the university. The lands were managed by the territory, and later the state of Alaska. In accordance with a 1982 agreement, the lands were subsequently transferred to the Board of Regents, as trustee. In 1982 and 1988 certain state lands including timber and other rights were transferred to the trust as replacement for lands disposed of or adversely affected during the period of administration by the territory and the state. These lands and property interests were recorded at their fair value as of the date of transfer. The net proceeds from timber, land and other rights are deposited in the land grant endowment trust fund described under Endowments in Note 1 above. At June 30, 2004 and 2003, approximately 84,000 and 86,000 acres, respectively, were held in trust at no basis because fair value at the date of transfer was not determinable.

7. Capital Assets:

A summary of capital assets follows (in thousands):

	Balance July 1, 2003	Additions	Reductions	Balance June 30, 2004
Capital assets not depreciated				
Land	$ 25,949	$ 1,332	$ -	$ 27,281
Construction in progress	94,212	81,452	103,541	72,123
Library and museum collections	47,917	1,729	-	49,646
Other capital assets				
Buildings	755,084	102,265	-	857,349
Infrastructure	33,514	-	-	33,514
Equipment	161,503	34,213	7,100	188,616
Leasehold improvements	4,845	-	-	4,845
Other improvements	20,320	449	-	20,769
Total	1,143,344	221,440	110,641	1,254,143
Less accumulated depreciation:				
Buildings	304,452	38,786	-	343,238
Infrastructure	21,191	1,189	-	22,380
Equipment	100,250	19,189	6,586	112,853
Leasehold improvements	1,857	242	-	2,099
Other improvements	11,739	1,077	-	12,816
Total accumulated depreciation	439,489	60,483	6,586	493,386
Capital assets, net	$ 703,855	$ 160,957	$ 104,055	$ 760,757

	Balance July 1, 2002	Additions	Reductions	Balance June 30, 2003
Capital assets not depreciated				
Land	$ 24,303	$ 1,799	$ 153	$ 25,949
Construction in progress	52,942	82,007	40,737	94,212
Library and museum collections	46,347	1,570	-	47,917
Other capital assets				
Buildings	714,759	40,368	43	755,084
Infrastructure	33,515	-	1	33,514
Equipment	142,466	27,872	8,835	161,503
Leasehold improvements	4,845	-	-	4,845
Other improvements	19,950	370	-	20,320
Total	1,039,127	153,986	49,769	1,143,344
Less accumulated depreciation:				
Buildings	262,875	41,620	43	304,452
Infrastructure	19,648	1,543	-	21,191
Equipment	93,319	14,942	8,011	100,250
Leasehold improvements	1,615	242	-	1,857
Other improvements	10,402	1,337	-	11,739
Total accumulated depreciation	387,859	59,684	8,054	439,489
Capital assets, net	$ 651,268	$ 94,302	$ 41,715	$ 703,855

8. Long-term Debt:

Debt service requirements at June 30, 2004 were as follows (in thousands):

Year ended June 30,	Principal	Interest	Total
2005	$ 4,855	$ 4,289	$ 9,144
2006	4,823	4,142	8,965
2007	4,899	3,990	8,889
2008	5,023	3,829	8,852
2009	4,314	3,672	7,986
2010-2014	23,401	15,963	39,364
2015-2019	25,491	11,355	36,846
2020-2024	27,663	5,910	33,573
2025-2029	11,405	1,607	13,012
2030-2031	1,220	58	1,278
	$ 113,094	$ 54,815	$ 167,909

Long-term debt consisted of the following at June 30, 2004 and 2003 (in thousands):

	2004	2003
Note payable – capital construction 1.826% assisted note to the Alaska Housing Finance Corporation (AHFC) to finance construction of Anchorage campus housing, payable beginning August 1999 to February 2024. In 1996, the university entered into an agreement with AHFC to borrow a total of $33 million, of which $30 million was issued on an assisted basis with interest at 1.826% and an additional $3 million issued on an unassisted basis at 6.0%	$ 27,734	$ 28,831
Note payable – quasi-endowment funds 5.0% note to finance purchase of two buildings located on University Lake Drive in Anchorage, refinanced in 2004 with issuance of Series M revenue bonds	-	2,357
Revenue bonds payable 1.40% to 5.90% general revenue bonds due serially to 2031, secured by a pledge of unrestricted current fund revenue generated from tuition, fees, recovery of facilities and administrative costs, sales and services of educational departments, miscellaneous receipts and auxiliaries	84,430	68,465
Installment contracts 1.94% to 5.44% installment contracts for the purchase of air traffic control simulation equipment and vehicles due in quarterly installments through June 2008	930	662
	$ 113,094	$ 100,315

On December 9, 2003, the university issued Series L general revenue bonds totaling $9,970,000. The bonds mature on October 1, 2030 and bear interest at rates ranging from 3 percent to 4.7 percent. Series L bond proceeds totaling $7,780,000 are being used for capital improvement projects, while the remaining $2,190,000 was used to redeem all of 1993 Series F general revenue bonds. The current refunding results in an economic gain of approximately $29,000 and total debt service payments over four years decrease $51,000.

On January 8, 2004, the university issued Series M general revenue bonds totaling $11,070,000. The bonds mature on October 1, 2028 and bear interest at rates ranging from 3.25 percent to 4.75 percent. Series M bond proceeds totaling $8,680,000 are being used for capital improvement projects and acquisition of real estate, and the remaining $2,390,000 was used to refinance a deed of trust note originally issued for the purchase of two buildings located in Anchorage.

In fiscal year 2004, the state reimbursed the university for debt service of $1,412,928 on Series K general revenue bonds. Subject to annual appropriation, the state will reimburse the university for principal and interest on $20,400,000 of the remaining bond principal. Annual debt service on this portion of the bonds is approximately $1.4 million.

In prior years, the university defeased housing system revenue bonds and certain general revenue bonds by placing the proceeds of new bonds in irrevocable trusts to provide for all future debt service payments on the old bonds. Trust assets and related liabilities for the defeased bonds are not included in the university's financial statements. At June 30, 2004 and 2003, outstanding defeased bonds were $0.4 million and $0.6 million, respectively.

Under the terms of the 1992 General Revenue Bonds Trust Indenture, the university is required to maintain a reserve account with a trustee at an amount equal to one-half of the maximum annual debt service. The balance in the reserve account at June 30, 2004 and 2003 was $3.6 million and $3.1 million, respectively. The reserve balance at June 30, 2004 includes a reserve fund policy, purchased with the issuance of Series L, totaling $0.6 million.

9. Deferred Lease Revenue:

In fiscal year 1997, the university entered into an agreement to construct a facility and establish the International Arctic Research Center (IARC). The university received $19,215,000 through a Japanese non-profit corporation to support the construction of the IARC in exchange for a commitment to provide research facilities to various Japanese research organizations and agencies for a period of 25 years, including lease extensions. The Japanese research organizations began occupying the IARC in fiscal year 1999. The deferred lease revenue at June 30, 2004 is $12,489,750 and is reduced at the rate of $1,281,000 per year with a corresponding increase to other operating revenue.

10. Long-term Liabilities:

Long-term liability activity was as follows (in thousands):

	Balance July 1, 2003	Additions	Reductions	Balance June 30, 2004	Amounts due within one year
Capital appropriation advances	$ 14,684	$ 7,282	$ 13,333	$ 8,633	$ -
Deferred lease revenue	13,771	-	1,281	12,490	1,281
Long-term debt	100,315	21,658	8,879	113,094	4,855
Security deposits and other liabilities	4,564	931	-	5,495	-
	$ 133,334	$ 29,871	$ 23,493	$ 139,712	$ 6,136

	Balance July 1, 2002	Additions	Reductions	Balance June 30, 2003	Amounts due within one year
Capital appropriation advances	$ 8,946	$ 6,949	$ 1,211	$ 14,684	$ -
Deferred lease revenue	15,051	-	1,280	13,771	1,281
Long-term debt	73,929	33,921	7,535	100,315	4,354
Security deposits on other liabilities	5,670	113	1,219	4,564	-
	$ 103,596	$ 40,983	$ 11,245	$ 133,334	$ 5,635

11. Capital Appropriations and Construction Commitments:

Major construction projects of the university are funded primarily by State of Alaska appropriations and university revenue bonds. The appropriations are financed through state-issued general obligation bonds or capital project bonds issued by the Alaska Housing Finance Corporation, a component unit of the State of Alaska, while other appropriations are received directly from the state or state agencies.

Unexpended and unbilled capital funds appropriated by the State of Alaska in prior years, which are not reflected as appropriation revenue or receivables on the university's books at June 30, 2004, totaled $47.5 million. In addition, unexpended proceeds of university-issued general revenue bonds designated for construction projects totaled $10.2 million at June 30, 2004.

Construction commitments at June 30, 2004 aggregated $20.8 million. At June 30, 2004, the university had received $8.6 million from State of Alaska capital appropriations and other sources in advance of expenditures.

12. Pension Plans:

Substantially all regular employees participate in either the State of Alaska Public Employees' Retirement System (PERS), an agent multiple-employer public employees' retirement system, the State of Alaska Teachers' Retirement System (TRS), a cost-sharing multiple-employer plan, or the University of Alaska Optional Retirement Plan (ORP), a single-employer defined contribution plan. In addition, substantially all regular employees and faculty classified as temporary participate in the University of Alaska Pension Plan, a supplemental single-employer defined contribution plan. None of the retirement systems or plans own any notes, bonds or other instruments of the university.

Defined Benefit Plans:

<u>State of Alaska Public Employees' Retirement System (PERS)</u>

Plan Description

The university contributes to PERS, a defined benefit, agent multiple-employer public employee retirement system established and administered by the State of Alaska (State). PERS provides pension, postemployment health care, death and disability benefits to eligible participants. Benefit and contribution provisions are established by State law and may be amended only by the State Legislature.

Each fiscal year, PERS issues a publicly available financial report which includes financial statements and required supplementary information. That report may be obtained by writing to the State of Alaska, Department of Administration, Division of Retirement and Benefits, P.O. Box 110203, Juneau, Alaska, 99811-0203 or by calling (907)465-4460.

Funding Policy and Annual Pension Cost

Employee contribution rates are 7.5% for peace officers and firefighters and 6.75% for other employees, as required by State statute. The funding policy for PERS provides for periodic employer contributions at actuarially determined rates that, expressed as a percentage of annual covered payroll, are sufficient to accumulate the assets to pay benefits when due.

The university's annual pension cost for the current year and related information is as follows:

	Pension	Postemployment healthcare	Total
Contribution rates:			
Employee:			
Peace officers and firefighters	5.27%	2.23%	7.50%
Other employees	4.74%	2.01%	6.75%
Employer	3.92%	1.66%	5.58%
Annual pension cost	$4,729,156	$2,002,717	$6,731,823
Contributions made	$4,729,156	$2,002,717	$6,731,823
Actuarial assumptions:			
Inflation rate	3.50%	Same	
Investment return	8.25%	Same	
Projected salary increase:			
Inflation	3.50%	N/A	
Productivity and merit:			
Peace officers and firefighters	2.50%	N/A	
Others	2.00%	N/A	
Health cost trend	N/A	12.0%	

The actuarial valuation date was June 30, 2003. The projected unit cost credit method is used and the initial unfunded accrued liability and future gains/losses are amortized as a 25-year fixed period level percentage of pay. Effective June 30, 2002, the asset valuation method recognizes 20 percent of the investment gain or loss in each of the current and preceding four years. This method will be phased in over the next five years.

During 2004, the annual required contribution (ARC) and the amount contributed by the university for the annual pension cost (APC) was $6,731,823. The university has fully funded its pension obligation; therefore, no net pension obligation (NPO) existed at fiscal year end.

Three year trend information follows:

	Year ended June 30	APC	Employer contribution rate	Percentage of APC contributed	NPO
Pension:	2002	3,006,906	2.90%	100%	-
	2003	3,306,428	2.90%	100%	-
	2004	4,729,156	3.92%	100%	-
Postemployment Healthcare:	2002	1,219,245	1.18%	100%	-
	2003	1,340,695	1.18%	100%	-
	2004	2,002,717	1.66%	100%	-

In the current fiscal year, the University determined, in accordance with provisions of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers* (GASB 27), that no pension liability existed to PERS and there were no previously reported liabilities to PERS.

Pension and Postemployment Healthcare Benefits
(in thousands)

	Actuarial valuation year ended June 30	Actuarial value of plan assets	Actuarial accrued liability (AAL)	(Unfunded) overfunded actuarial accrued liability (UAAL)	Funded ratio	Covered payroll	UAAL as a percentage of covered payroll
Pension benefits:							
	2001	360,222	331,693	28,529	109%	93,210	N/A
	2002	301,429	402,604	(101,175)	75%	102,892	98%
	2003	313,807	419,463	(105,656)	75%	113,096	93%
Postemployment healthcare benefits:							
	2001	152,517	140,438	12,079	109%	93,210	N/A
	2002	183,143	244,615	(61,472)	75%	102,892	60%
	2003	209,738	280,355	(70,617)	75%	113,096	62%
Total:							
	2001	512,739	472,131	40,608	109%	93,210	N/A
	2002	484,572	647,219	(162,647)	75%	102,892	84%
	2003	523,545	699,818	(176,273)	75%	113,096	81%

State of Alaska Teachers' Retirement System (TRS)

Plan Description

TRS provides pension, postemployment health care, death and disability benefits to participants. Benefit and contribution provisions are established by State law and may be amended only by the State Legislature.

Each fiscal year, TRS issues a publicly available financial report which includes financial statements and required supplementary information. That report may be obtained by writing to the State of Alaska, Department of Administration, Division of Retirement and Benefits, P.O. Box 110203, Juneau, Alaska, 99811-0203 or by calling (907) 465-4460.

Funding Policy

Employees contribute 8.65% of their base salary as required by State statute. The funding policy for TRS provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are sufficient to accumulate sufficient assets to pay benefits when due. During fiscal year 2004, required employee and employer contribution rates were 8.65% and 12%, respectively. The amounts contributed to TRS by the university during the years ended June 30, 2004, 2003 and 2002 were $4,860,511, $4,281,511, and $4,196,154, respectively, equal to the required employer contributions for each year.

Defined Contribution Plans:

University of Alaska Optional Retirement Plan (ORP)

Faculty classified as regular and certain administrators may make a one-time election to participate in the ORP as an alternative to participation in PERS or TRS. The ORP is an employer funded defined contribution plan which operates in conjunction with a companion mandatory tax-deferred annuity plan. ORP participants are required to make employee contributions to one of the plan's authorized tax-deferred annuity programs at a rate equivalent to the TRS employee contribution rate of 8.65%. The university makes matching employer contributions to one of the plan's authorized employee-selected annuity providers or investment managers at a rate equal to the three-year moving average of the TRS employer contribution rates (11.33% for FY04 and 11.33% for FY03). In fiscal year 2004 and 2003, the university's total covered payroll for the ORP plan was approximately $50.9 million and $46.5 million, respectively. The amounts contributed to ORP by the university during the years ended June 30, 2004, 2003 and 2002 were $5,761,999, $5,266,348, and $4,729,946, respectively. At June 30, 2004 and 2003, plan assets (participants' accounts attributable to employer contributions) had a net value of approximately $48.3 million and $38.6 million, respectively. Each participant is 100% vested at all times.

University of Alaska Pension Plan (Pension)

In addition to the other retirement plans, substantially all regular employees and faculty classified as temporary participate in the Pension plan which was established effective January 1, 1982, when the university withdrew from the federal social security program. Effective January 1, 2004, employer contributions for regular employees were 7.65% of covered wages up to a maximum of $42,000 and $87,900 for certain faculty classified as temporary. The plan provides for employer contributions to be invested in accordance with participant-directed investment elections to the plan's fixed income and/or equity funds. Each participant is 100% vested at all times.

In 2004 and 2003, the university's total covered payroll for the Pension plan was approximately $165.2 million and $160.9 million, respectively. The university's costs to fund and administer the plan amounted to approximately $12.7 million, or 7.66% of covered payroll. At June 30, 2004 and 2003, plan assets (participants' accounts) had a net value of approximately $246.3 million and $214.5 million, respectively.

13. Insurance and Risk Management:

The university is exposed to a wide variety of risks including property loss, bodily and personal injury, intellectual property, errors and omissions, aviation and marine. Exposures are handled with a combination of self-insurance, commercial insurance, and membership in a reciprocal risk retention group. The university is self-insured up to the maximum of $2 million per occurrence for casualty claims and $250,000 for property claims. Commercial carriers provide coverage in excess of these amounts. Health care, workers' compensation and unemployment claims are fully self-insured.

Liabilities have been established to cover estimates for specific reported losses, estimates for unreported losses based upon past experience modified for current trends, and estimates of expenses for investigating and settling claims.

Changes in applicable liability amounts follow (in thousands):

	Balance July 1, 2003	Provision for Claims	Claims Payment	Balance June 30, 2004
Health	$ 6,928	$ 34,127	$ (34,550)	$ 6,505
General liability	8,176	189	(1,098)	7,267
Workers' compensation	4,180	1,645	(1,139)	4,686
Unemployment	137	620	(624)	133
	$ 19,421	$ 36,581	$ (37,411)	$ 18,591

	Balance July 1, 2002	Provision for Claims	Claims Payment	Balance June 30, 2003
Health	$ 7,563	$ 28,518	$ (29,153)	$ 6,928
General liability	7,885	724	(433)	8,176
Workers' compensation	4,012	1,463	(1,295)	4,180
Unemployment	118	544	(525)	137
	$ 19,578	$ 31,249	$ (31,406)	$ 19,421

14. Commitments and Contingencies:

Amounts received and expended by the university under various federal and state grants, contracts and other programs are subject to audit and potential disallowance. From time to time the university is named as a defendant in legal proceedings or cited in regulatory actions related to the conduct of its operations. In the normal course of business, the university also has various other commitments and contingent liabilities which are not reflected in the accompanying financial statements. In the opinion of management, the university will not be affected materially by the final outcome of any present legal proceedings, environmental investigations, audit adjustments, or other commitments and contingent liabilities.

15. University of Alaska Foundation:

The University of Alaska Foundation (foundation) is a legally separate, non profit organization formed in 1974 to solicit donations for the exclusive benefit of the University of Alaska. During 2004 and 2003, the university transferred $142,544 and $115,157, respectively, to the foundation. For the same periods, distributions and expenditures by the foundation for the benefit of the university totaled $12.1 million and $8.7 million, of which $11.9 million and $8.5 million were direct reimbursements to the university. At June 30, 2004 and 2003 the foundation owed the university $3.6 million and $1.6 million, respectively, primarily for reimbursement of museum construction expenditures and other grant and contract and scholarship expenditures. The university provides in-kind administrative and accounting support for the foundation, the costs of which are included as expenditures in the university's financial statements.

The investable resources of the university's land grant endowment trust fund and the foundation's pooled endowment funds are combined into a consolidated fund (fund) for investment purposes. At June 30, 2004 and 2003, the fair value of the fund was $161.1 million and $134.9 million, respectively. The university's share of this fund was $91.8 million and $79.6 million, which is reflected in endowment investments. The fund is managed by the foundation's investment committee and treasurer on a total return basis in accordance with an investment policy approved by the Board of Regents. The net assets and related activity for the university's land grant endowment trust's investment in the fund is reflected in the university's financial statements.

16. Functional Classifications with Natural Classifications:

The university's operating expenses by natural classification were as follows (in thousands):

	Year ended June 30, 2004						
	Compensation & Benefits	Contractual Services	Supplies & Materials	Other	Student Aid	Depre-ciation	Total
Instruction	$ 116,128	$ 19,108	$ 8,501	$ 378	$ -	$ -	$ 144,115
Academic support	27,307	5,575	4,144	69	-	-	37,095
Research	70,009	32,226	9,653	125	-	-	112,013
Public service	17,179	7,502	1,546	(11)	-	-	26,216
Student services	23,787	6,894	2,303	18	-	-	33,002
Operations and maintenance	19,877	7,567	11,135	605	-	-	39,184
Institutional support	37,444	9,321	3,271	254	-	-	50,290
Student aid	-	-	-	-	13,052	-	13,052
Auxiliary enterprises	7,438	13,897	12,160	291	-	-	33,786
Depreciation	-	-	-	-	-	60,483	60,483
	$ 319,169	$ 102,090	$ 52,713	$ 1,729	$ 13,052	$ 60,483	$ 549,236

	Year ended June 30, 2003						
	Compensation & Benefits	Contractual Services	Supplies & Materials	Other	Student Aid	Depre-ciation	Total
Instruction	$ 106,998	$ 18,957	$ 7,882	$ 355	$ -	$ -	$ 134,192
Academic support	24,404	5,162	4,655	58	-	-	34,279
Research	63,465	35,726	8,415	9	-	-	107,615
Public service	15,418	8,301	1,228	20	-	-	24,967
Student services	22,019	7,178	2,145	(19)	-	-	31,323
Operations and maintenance	20,468	8,452	10,758	613	-	-	40,291
Institutional support	40,655	9,136	3,852	(114)	-	-	53,529
Student aid	-	-	-	-	10,441	-	10,441
Auxiliary enterprises	7,427	12,344	11,865	191	-	-	31,827
Depreciation	-	-	-	-	-	59,684	59,684
	$ 300,854	$ 105,256	$ 50,800	$ 1,113	$ 10,441	$ 59,684	$ 528,148